IN THE

Supreme Court of the United States

October Term, 1970

No. 373

In the Matter of

CARNELL CONSTRUCTION CORP., a corporation of the State of New York, authorized to do business in the State of New Jersey

JAMES E. MASTERSON,
Receiver-Petitioner,

vs.

VALLEY NATIONAL BANK OF LONG ISLAND,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Vital Conceded Fact

For all purposes herein and before presenting the issues, it is conceded that the subject matter of the Receiver's petition is totally foreign and unrelated to the subject matter of the secured proof of debt filed by Respondent, *infra.*

Questions Presented

1. Did the Bankruptcy Court for the District of New Jersey, in a Chapter XI proceeding, acquire summary jurisdiction over Respondent, a national bank with a head office located in Nassau County, State of New York, to make a summary affirmative order on the receiver's separate, independent, turnover petition solely and only by reason of the filing by Respondent of a secured proof of debt on two Cadillac cars not in the possession of Respondent?

2. Should this court accept jurisdiction on a purely procedural step not affecting the substantive rights of the Receiver when the Receiver had and still has an absolute right, be he so advised, to commence a plenary action for that which he seeks summarily in the county wherein Respondent bank maintains its head office (12 U.S.C. 94)?

Counterstatement of Facts

A counterstatement of the facts is felt to be necessary for a proper determination on this petition for certiorari.

The statement of case contained at page 3 of the Receiver's petition is totally inadequate.

(a) Respondent is a national bank having its head office located in Nassau County, State of New York, within the federal jurisdiction of the United States District Court, Eastern District of New York.

(b) All of the transactions of and concerning the subject matter of the secured proof of debt and of the Receiver's subsequent turnover petition and all of the witnesses involved thereon are situated within Nassau County, except for the Receiver and his counsel. They alone are from New Jersey.

(c) On March 28, 1968 Respondent filed with the Bankruptcy Referee a secured proof of debt covering two Cadillac cars. Neither car was in the bank's possession. Respondent, however, had, more than four months prior thereto, perfected its security interest therein by virtue of the due filing of financing statements with the Clerk of the County of Nassau and with the Secretary of State of the State of New York pursuant to UCC 9-401 (1)(c).

(d) Some two months thereafter, on May 21, 1968, the Receiver by order to show cause and petition moved for a summary turnover order of certain monies which Respondent previously set-off as against the amount of Carnell's indebtedness to the bank.

(e) It is conceded that the set-off and the facts bottoming it had nothing whatever to do and was completely foreign and totally unrelated to the subject matter of the secured proof of debt.

(f) The Receiver neither served nor filed any Bankruptcy Act 57 (g) objection (or any objection for that matter) to the secured proof of debt.

(g) Respondent then filed a special appearance and moved to dismiss the petition of the Receiver on the grounds that the Bankruptcy Court lacked summary jurisdiction over this New York based national bank.

Dispositions Leading up to This Petition

1. The Bankruptcy Referee on September 20, 1968, dismissed the special appearance and denied Respondent's motion to dismiss the Receiver's petition holding that *Katchen* v. *Landy*, 382 U.S. 323, 86 Sup. Ct. 467, was dispositive notwithstanding that the subject matter of the petition was totally unrelated to the subject matter of the secured proof of debt and notwithstanding that Respondent never consented, expressly, by implication, or by waiver to be sued other than within the County or the Federal District wherein its head office is located.

2. The District Court of New Jersey (Hon. JAMES A. COOLAHAN, Judge) on petition for review, reversed the Bankruptcy Referee, holding that *Katchen* v. *Landy*, *supra*, was not dispositive of the facts in this case involving an unrelated counterclaim; that in such a situation, the court would not obtain summary jurisdiction; the effect of the court's decision was that it would not extend the vitiation of Respondent's right to be sued in a plenary action with the attendant rights of jury trial and disclosure; nor, would the District Court by judicial fiat nullify the Respondent's statutory rights under 12 U.S.C. 94.

3. The Court of Appeals for the Third Circuit by decision filed April 10, 1970 and judgment entered April 11, 1970, affirmed the order of the District Court.

Reasons for Denial of the Writ

1. The decision of the Court of Appeals is not in conflict with *Katchen* v. *Landy, supra.*

At the outset it should be noted that Respondent has urged in all courts below that it had the right afforded it venuewise in 12 U.S.C. 94 and that this right was never waived. Neither the District Court nor the Court of Appeals found it necessary, however, to reach this point.

Moreover, it was pointed out by Respondent in each court below that the Receiver was not without relief. For under 11 U.S.C. Sec. 46(b) (Bankruptcy Act Sec. 23(b)), the Receiver could bring an action wherein the bankrupt (or debtor in possession) might have brought or prosecuted such an action and such court is jurisdictionally limited to the county wherein the head office of the national bank is located (12 U.S.C. 94).

The history leading up to *Katchen* clearly supports the views of Judge COOLAHAN and of the Circuit Court as expressed in their opinions.

Prior to *Katchen,* the law had been that a creditor's claim for allowance could be successfully defensed by the assertion of a 57 (g) objection on a related counterclaim.*

* It is to be noted that no question exists as to allowance of Respondent's secured proof of debt. Respondent being secured, the proceeding being under Chapter XI, Respondent's claim to the vehicles was not involved. Respondent therefore never sought allowance and 57 (g) had no application. This brief, however, is submitted under the *arguendo* assumption that it did. It is likewise assumed *arguendo* only that the Receiver's petition alleged a preferential claim; a fact found to be otherwise by the Circuit Court.

In litigating the issue of allowability, it was perforce necessary to determine the question of a preference and if so, the amount thereof. For before allowing a related claim, the preferential claim by statute (57 (g)) would have to be surrendered.

The problem which vexed the Circuits and led up to *Katchen* was whether in addition to disallowance under 57 (g) the Bankruptcy Court could advance the final step and summarily make an affirmative order granting the Trustee his relief on the related preference or relegate the Trustee to bringing a plenary action for this affirmative relief.

Res judicata and collateral estoppel were the two cogent reasons why affirmative relief should be allowed along with disallowance as one complete step. The issue of preference being necessarily determined as part of the allowance process and all parties being before the court, it became an exercise in futility and slavery as to form over substance to require the Trustee to bring a subsequent plenary suit with the plenary courts' hands tied by *res judicata* and collateral estoppel.

Undoubtedly, however, the Circuits approached the paradox circumspectly and warily, having in mind the repugnant *in terrorem* nature of 57 (g).

However, in weighing and balancing the equities, it was felt that where the counterclaim is related, the *in terrorem* repugnancy is overcome and the creditor seeking an allowance of a related claim could not be heard to contest a summary disposition on a counterclaim related to it. This

would follow public policy as expressed in the entire scheme of the Bankruptcy Act.

With the foregoing in mind, we approach *Katchen* v. *Landy, supra.*

In *Katchen*, the corporate bankrupt borrowed $50,000 from two local banks. Katchen as principal officer of the corporation was accommodation maker of notes delivered to the banks. After a disastrous fire, funds of the corporation were placed in a "trust account" under his sole control. From this account, he made two payments on one of the corporate notes and one on another.

Katchen filed two general claims seeking an allowance for rent due and for payment on one note from personal funds. The Trustee in each of three counterclaims asserted that the three payments made to Katchen from the "trust account" were voidable preferences, should be disallowed and in addition demanded affirmative relief. These three counterclaims were directly related to Katchen's claim for allowance. In addition, the Trustee counterclaimed for the amount due on a stock subscription. The first three counterclaims were preferential and related. The fourth was neither.

The Referee upheld jurisdiction on all four. The District Court on review affirmed jurisdiction on all four. The Court of Appeals affirmed except on the unrelated fourth counterclaim. On this it reversed. The Circuit Court held summary jurisdiction did not lie on the fourth unrelated counterclaim. Certiorari was never sought as to the fourth

unrelated counterclaim. Thus *Katchen* v. *Landy's* disposition thereof in the Circuit Court dismissing same has been permitted to stand.

In effect then, *Katchen* stands for the proposition that where the counterclaim alleges preference and is related a filed claim seeking its allowance confers summary jurisdiction—this and nothing more.

The main thrust of the Petitioner in *Katchen* v. *Landy* in the Supreme Court was that if Katchen did not file a claim for allowance and awaited the Trustee's onslaught, it would have to be plenary. There Katchen reasoned (not without logic) he would be entitled to a jury. Why should he be so barred he asks because he moved first by filing a claim? While not couched in so many words, in effect he was urging the *in terrorem* argument. This court, however, held otherwise in affirming the Circuit Court.

The foregoing analysis clearly upholds Judge Coolahan's expressed view in the District Court in the instant case:

> "* * * that distinction must be made between related and unrelated counterclaims, and that unrelated counterclaims have no place whatsoever in the Bankruptcy Court."

Thus, Mr. Justice White, speaking for the Supreme Court, in *Katchen*, resolved the issue as to related counterclaims explicitly. The issue on the unrelated counterclaim was resolved in the Tenth Circuit in the Court of Appeals as this was never appealed.

Mr. Justice WHITE expressed the issue in the *Katchen* case to be:

> "* * * whether a bankruptcy court has summary jurisdiction to order the surrender of voidable preferences asserted and proved by the trustee in response to a claim filed by the creditor who received the preference" (page 325) [where the counterclaims in response are related and where the claim is filed for allowance]

As stated by the learned Justice at page 326:

> "The crux of the dispute here concerns the mode of procedure for trying out the preference" * * *.

The diversity theretofore existing between the Circuits was then laid to rest. It no longer existed or exists. *Katchen* v. *Landy* finally determined that where a creditor seeks allowance of his claim and a related counterclaim is interposed as part and parcel of the allowance process, the Referee may make an affirmative order with respect to the preference.

The paradox of *res judicata* was thus overcome and a meaningless plenary action over an issue already judicially determined obviated.

Where, however, the counterclaim is unrelated, the *in terrorem* argument stands, and the claimant's constitutional rights on a totally unrelated claim will not be destroyed. Nor will he by threat of forfeiture of a claim be barred from asserting in the proceeding a just claim.

The law on unrelated counterclaims remains as it has always been. The courts will not summarily entertain them.

It is respectfully submitted that there is no conflict between the Circuits nor has the decision of the Court of Appeals in the court below conflicted with this court's interpretation of 57 (g) as found in *Katchen* v. *Landy*.

2. The questions presented are not of sufficient importance to require adjudication by this court.

Respondent did not have possession of the vehicles. Filing of the financing statements took place in the State of New York. The Chapter XI proceeding took place in the State of New Jersey.

There would be no way absent notification for the Receiver or the Bankruptcy Court to have notice of Respondent's security interest without some advice from Respondent. This advice took the form of the filing with the Bankruptcy Referee of the secured proof of debt not for the purpose of having the bank's claim allowed but rather to put the Receiver and the court on notice as to Respondent's security interest in the two vehicles and to thereby protect such security.

It would be a shameful abuse of the Respondent's actions to permit the Receiver to convert the foregoing into a jurisdictional trap from which extrication could be brought about only upon a forfeiture of constitutional rights.

As stated by the late Mr. Justice Cardozo when he sat on the New York State Court of Appeals:

> "The law has outgrown its primitive stage of formalism when the precise word was the sovereign talis-

man, and every slip was fatal. It takes a broader view today." (*Wood* v. *Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 91; 118 N.E. 214.)

The writer has put it somewhat more picturesquely and bluntly albeit perhaps inelegantly in his brief in the Court of Appeals. It was there urged that it was grossly insulting and manifestly repugnant to the courts to apply a flypaper theory of jurisdiction. That it was unseemly to attempt to stick unsuspecting secured claimants who filed their secured claims in good faith but by chance thereby brush the flypaper and find themselves facing an unrelated counterclaim in a foreign jurisdiction in a summary manner stripped of ancient rights dating to Runnymede in 1215.

Such is the net effect of the Receiver's argument.

That the questions presented are not of sufficient importance for this high court to accept the case is emphasized by the fact that no one loses rights by such refusal.

The Receiver is completely free to do what he could always do if he be so advised: commence a plenary action in the New York State Supreme Court in Nassau County or in the United States District Court, Eastern District of New York.

This case does not, in any sense, involve any broad new legal principles that have application beyond the scope of the fact pattern in this particular case nor is there any important question of constitutional law in the posture in which it comes before this high court.

CONCLUSION

The judgment below should be sustained in all respects and the petition for a writ of certiorari should be denied.

Respectfully submitted,

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